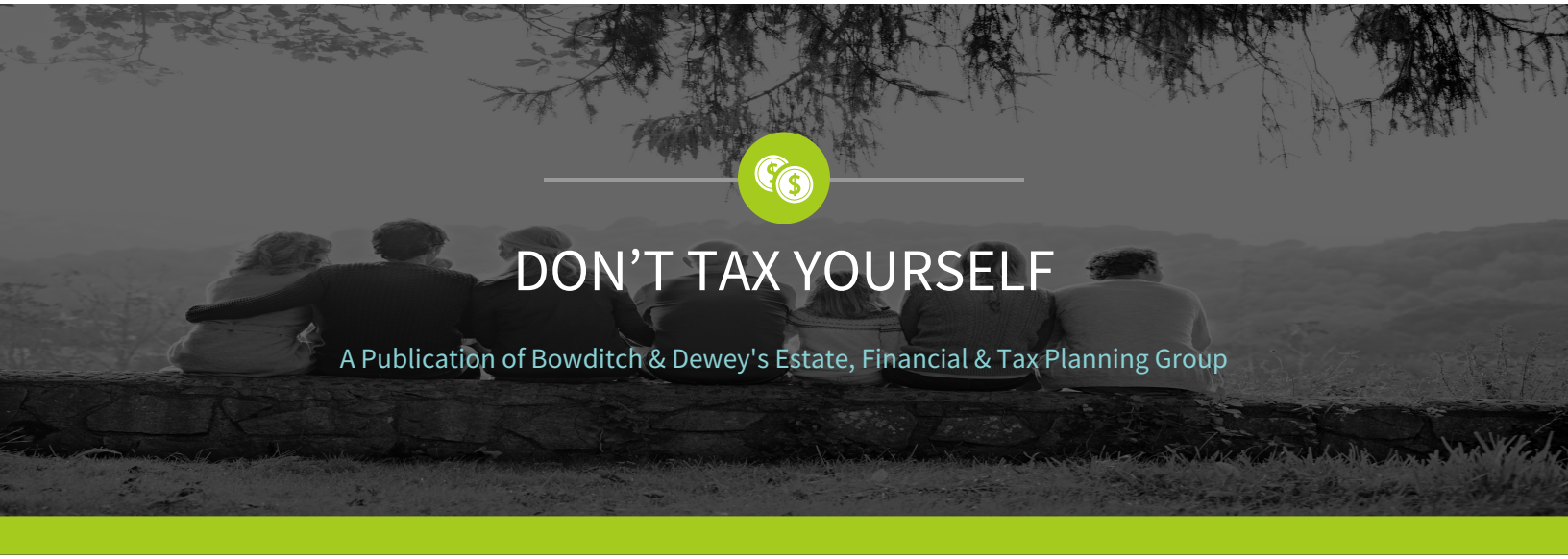

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A Publication of Bowditch & Dewey's Estate, Financial & Tax Planning Group

Impact of House Ways and Means Tax Proposals for International Operations

BY BOWDITCH & DEWEY • OCTOBER 4, 2021

In this final blog post on the House Ways and Means Tax Bill, we address the international tax proposals in the Bill, JCX-43-21. The international tax proposals are fewer in number than the domestic and transfer tax proposals, but fundamentally change Congress's approach with the Tax Cuts and Jobs Act of 2017 to provide carrots and sticks to multi-national businesses to invest in the United States. Therefore, it is helpful to review the history of the Tax Cuts and Jobs Act of 2017 (the 2017 Act) to understand the impact of the current House proposals.

Prior to 2017, the United States taxed U.S. multinational corporations on all income, wherever derived, at 35% corporate tax rates. The U.S. imposed this tax on business income earned by foreign subsidiaries generally only when the foreign subsidiary distributed such income to its U.S. parent. In addition, U.S. multinational corporations could offset such foreign income with credits for foreign taxes paid by the foreign subsidiary. Many countries outside the U.S., however, tax business income only when earned within their borders and at significantly lower rates than the U.S. Thus, foreign-based multi-national corporations could often operate with significantly lower effective tax costs than U.S.-based multinational corporations. In addition, U.S.-based multinational corporations who invested capital and jobs overseas, often in jurisdictions with lower effective tax rates, could operate with significantly lower tax costs than U.S.-based corporations with domestic operations. In particular, many U.S.-based multinational corporations moved intellectual property assets to low-tax jurisdictions (and related research and development jobs). The U.S. parent reinvested earnings from such foreign assets abroad, rather than repatriate the earnings to the U.S. to avoid U.S. corporate tax.

The 2017 Act changed this competitive world landscape by cutting the U.S. corporate tax rate to 21%. It eliminated the U.S. corporate tax on foreign subsidiary business income. The 2017 Act added a "stick" of a one-time corporate tax on U.S. corporate earnings invested overseas (at 15.5% or 8% rates, depending on whether the earnings were invested in cash or non-cash assets). In addition, the 2017 Act introduced a 10.5% current tax on foreign subsidiary income considered to be "global intangible low-taxed income" or "GILTI." GILTI is income generated by intangible assets held by foreign subsidiaries in low-tax jurisdictions. Under the 2017 Tax Act, the GILTI tax rate was scheduled to increase to

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13.125% for taxable years starting on January 1, 2026.

The 2017 Tax Cuts and Jobs Act reduced incentives for foreign multinational corporations with U.S. subsidiaries to reduce U.S. taxes with deductible-related party payments and U.S. subsidiary debt (and related interest costs). The 2017 Act reduced the interest expense tax deduction for U.S. corporations from 50% of adjusted taxable income to 30% of adjusted taxable income. In addition, the 2017 Act introduced a "Base Erosion and Anti-Abuse Tax" ("BEAT") on certain payments to foreign related parties from large corporations with more than $500 million in gross revenue. The BEAT operates as a minimum tax (10% for 2019 through 2025, and 12.5% for years after 2025) on such payments to foreign-related parties.

To encourage investment in U.S. industry, research, and development, the 2017 Act introduced a carrot of a lower tax rate for foreign export income, e.g., foreign sales or licenses of products or services made or provided by U.S. corporations. Under the 2017 Act, any U.S. corporation is taxed at a rate of 13.125% on this foreign-derived intangible income ("FDII"). The FDII tax rate is scheduled to increase to 16.406% for tax years starting on January 1, 2026.

In September 2021, however, the Congressional House Ways and Means Committee introduced the following international taxation proposals that would change again the U.S. multinational corporate tax landscape.

- First, the U.S. corporate tax rate would increase from 21% to 26.5% for corporations with revenue over $5 million.
- The U.S. deduction for interest expense would be further limited. Domestic corporations that are part of multinational groups with average annual business interest expense of more than $12 million would have to limit their interest deduction to 110% of the ratio of the relevant domestic corporation's financial statement earnings before interest, taxes, depreciation, and amortization ("EBITDA") to the consolidated group's financial statement EBITDA. Interest income disallowed as a result of the proposal would be carried forward for up to five years. Currently, as noted above, such business interest expense is deductible to the extent of 30% of the adjusted taxable income of the U.S. taxpayer and can be carried forward indefinitely.
- The proposal would increase the effective tax rate on foreign-derived intangible income or FDII to 20.7% (as compared to the proposed 26.5% corporate tax rate) and increase the tax rate on GILTI to 16.525%. The proposal prevents domestic corporations from offsetting GILTI income (and so-called subpart F, passive foreign income) with foreign tax credits from different, high-tax countries. The proposal also increases the GILTI tax further by reducing a U.S. shareholder's "net deemed tangible income return" that is exempt from such GILTI tax from the current 10% to a 5% tangible return.
- Finally, the proposal increases the applicability of BEAT to certain indirect costs paid to foreign related parties and applies the BEAT tax to *all* corporations with gross receipts more than $500 million. Current law limits the application of this additional tax only to corporations with base erosion payments that are more than 3% of the corporation's overall tax-deductible payments. In addition, the proposal would increase the BEAT from 12.5% to 15% for tax years beginning in 2026.

The House has not yet voted on the current proposed legislation. The international tax proposals, while seemingly small, take away the 2017 tax reform structure of providing both carrots and sticks to U.S. businesses to allow them to compete in the global economy with foreign businesses. It suggests a change in world view from a partnership between the U.S. government and U.S. multinational corporations to an economy with more government involvement. Please talk with your tax advisor if you have questions about any of the above proposals.

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